



# NEWS RELEASE

CALIFORNIA STATE TREASURER PHIL ANGELIDES

FOR IMMEDIATE RELEASE

October 24, 2002

## **ANGELIDES PRESSES INVESTMENT BANKS TO COMPLY WITH REFORMS – *SUSPENDS FIRM and URGES SEC TO IMPOSE NATIONAL STANDARDS***

**SACRAMENTO, CA** – California State Treasurer Phil Angelides today announced actions by his office to press investment banks to fully comply with the ‘Investment Protection Principles’ he adopted in July. The Principles called on investment banks to meet new standards of disclosure and conduct or risk losing the right to do business with the State.

The Principles are based on a landmark agreement by New York Attorney General Eliot Spitzer and Merrill Lynch and Co., following revelations that Merrill Lynch research analysts publicly touted stocks of the firm’s banking clients while privately disparaging the same stocks in internal emails.

In July 2002, Angelides asked banks to certify by September 15 their full compliance with the Principles. Today’s actions came after a detailed review of their responses.

“Although we have made meaningful progress on compelling investment banks to meet tough standards of disclosure and conduct, we are not satisfied with the level of compliance to date,” Treasurer Angelides said. Consequently, the Treasurer today announced he had taken the following actions:

- Suspended HSBC Securities Inc. -- a firm that refused to adopt two of the Principles, and in fact, failed to comply with five of the six Principles -- effective November 15, 2002, unless the Treasurer’s Office receives from HSBC a written commitment to comply with all of the required Principles. HSBC has done \$8.4 billion in transactions with the Pooled Money Investment Account (PMIA), a \$49 billion fund comprised of State and local taxpayer dollars managed by the Treasurer’s Office, since 1997.
- Notified 22 investment banks that their level of compliance was not acceptable, and that they must come into full compliance by January 15, 2003 or risk losing the right to do business with the State. While these 22 firms had indicated their intention to abide by the new rules, a review by the Treasurer’s Office showed varying degrees of compliance that the Treasurer called ‘inadequate.’
- Urged the Securities and Exchange Commission (SEC) to expeditiously adopt tough, uniform, national rules to be applied to investment banks. In a letter to SEC Chairman Harvey Pitt, the Treasurer urged the SEC to support the efforts of New York Attorney General Spitzer to ensure rapid adoption of such rules. Angelides said that while strong national standards are preferable, he would move forward to enforce his policies until such time as the SEC acts.

Angelides further commented, “Our goal is to protect investors, taxpayers, and pensioners by using our financial power to help restore integrity to the marketplace. Demanding strict standards of ethics and accountability from the firms with whom we do business is critical to that effort.”

Attached is a copy of the Treasurer’s statement issued today, and his letter to the SEC.

**Statement of California State Treasurer Phil Angelides regarding Enforcement of  
the Investment Protection Principles**

**October 23, 2002**

On July 1, 2002, I joined New York State Attorney General Eliot Spitzer, North Carolina Treasurer Richard Moore, and New York State Comptroller Carl H. McCall in adopting Investment Protection Principles (Principles) to be applied to the investment banks doing business with the State of California. This initiative was undertaken — in the wake of revelations of improper conduct by investment banking firms — to protect investors, taxpayers, and pensioners and to help restore integrity to the financial marketplace. Upon adopting the Principles, this office formally notified each investment bank eligible to conduct business with the State that compliance with the Principles would be given significant consideration when this office determined whether to hire or retain an investment bank to do business with the State.

These Principles are based on the agreement that Attorney General Spitzer reached with Merrill Lynch & Co., Inc. on May 21, 2002. The Principles include, among other items:

- Severing the link between compensation for analysts and investment banking;
- Prohibiting investment banking input into analyst compensation;
- Creating a review committee to approve all research recommendations;
- Requiring that upon discontinuation of research coverage of a company, firms will disclose the coverage termination and the rationale for such termination;
- Disclosing in research reports whether the firm has received or is entitled to receive any compensation from a covered company over the past 12 months; and
- Establishing a monitoring process to ensure compliance with the Principles.

To implement the Principles, on July 24, 2002, I sent a letter and questionnaire to firms eligible to provide underwriting services for the State's debt and bond issuances ("Underwriters Pool") and to firms eligible to conduct business as broker/dealers with the State's \$49 billion Pooled Money Investment Account (PMIA List) informing them of this Office's policy and requesting that they adopt and implement the Principles. Firms that qualified as "financial organizations" — those that provide both equity research and investment-banking services to clients — were requested to certify, by September 15, 2002, that they had adopted and implemented a policy that meets or exceeds the substantive requirements of the Principles. In the alternative, firms were given the option of certifying that they are committed to adopting and implementing the Principles and that they will submit their policies by December 15, 2002.

A total of 54 firms in the Underwriters Pool and on the PMIA List qualify as financial organizations. Twenty-six firms responded that they had adopted and implemented the Principles as of September 15, 2002. Twenty-eight firms responded that they would commit to and adopt the Principles by December 15, 2002.

After a review by this office, we have determined that, of the 26 firms that responded by September 15, three firms are in full compliance — Merrill Lynch, the Chapman Company, and the Williams Company. One firm — HSBC Securities (USA) Inc. — refused to adopt two of the Principles and, in fact, failed to comply with three of the four remaining Principles. While the other 22 firms indicated their intent to adopt and implement the Principles, there were, in fact, varying degrees of compliance: for example, some did not provide an adopted policy that would substantiate their certification of compliance, while others submitted policies that did not fully address the substance of the Principles.

While our State's collective efforts to implement the Principles have resulted in meaningful progress with respect to investment bank and broker/dealer practices, this office is not satisfied with the degree of compliance indicated in the initial responses. We remain committed to ensuring that the Principles are broadly implemented in the financial marketplace and believe that compliance with the Principles is important to protect investors, taxpayers, and pensioners. Therefore, today I am taking the following actions as Treasurer of the State of California:

1. I am suspending HSBC Securities (USA) Inc. from the PMIA List, effective November 15, 2002, unless this office receives a written commitment by November 15, 2002, to adopt a revised policy that meets all of the required Principles by no later than January 15, 2003. This office has notified HSBC Securities (USA) Inc. by letter of this action.
2. Because of the level of compliance to date, I am strongly urging the Securities and Exchange Commission (SEC) to expeditiously adopt tough, uniform rules applied to investment banks that will protect investors, taxpayers, and pensioners and renew faith in our financial markets. In that vein, I have sent letters to the SEC and other relevant parties on this matter.

I applaud the decision of Attorney General Spitzer, the SEC, the New York Stock Exchange (NYSE), the National Association of Securities Dealers, Inc. (NASD), and the North American Securities Administrators Association (NASAA) to work together to forge comprehensive and rigorous standards for investment banks. I hope that their combined efforts put into place high standards that will foster public confidence in our financial markets.

3. I will continue our efforts to ensure that investment banks doing business with the State of California implement the Principles until such time as the SEC and the self-regulatory organizations adopt adequate rules. While a federal regulatory framework is clearly preferable and necessary, in the absence of the adoption of national standards, this office will move ahead to seek compliance by investment banks with the Principles. Accordingly, I have sent letters to the 22 firms whose policies are inadequate asking them to come into compliance. For the 28 firms that intend to respond by December 15, 2002, I have sent letters notifying them that I expect to receive policies that reflect the fullest possible compliance with the Principles.

After consulting with Attorney General Spitzer, I am extending the time for the firms to submit their revised or initial plans to January 15, 2003, to give his efforts time to succeed. If comprehensive, national standards are adopted by January 15, I will re-evaluate implementation of this office's policy at that time.

October 23, 2002

Harvey L. Pitt, Chairman  
Securities and Exchange Commission  
450 Fifth Street, NW  
Washington, DC 20549-0609

Dear Mr. Pitt:

In July, I joined with New York State Attorney General Eliot Spitzer, North Carolina Treasurer Richard Moore, and New York State Comptroller Carl H. McCall to endorse the Investment Protection Principles (Principles), which are based on the May 21, 2002, agreement between Merrill Lynch & Co., Inc. and Attorney General Eliot Spitzer. Accordingly, I formally notified each investment bank eligible to conduct business with the State of California that compliance with the Principles would be given significant consideration when this Office determined whether to hire or retain an investment bank to do business with the State. Each firm was asked to certify that they had adopted and implemented the Principles by September 15, 2002, or, in the alternative, certify that they would adopt and implement them by December 15, 2002.

After our review of the 26 firms that responded that they had adopted and implemented plans as of September 15, 2002, we have determined that three firms are in full compliance. One firm — HSBC Securities (USA) Inc. — refused to adopt two of the Principles and, in fact, failed to comply with three of the four remaining Principles. While the other 22 firms indicated their intent to adopt and implement the Principles, there were, in fact, varying degrees of compliance: for example, some did not provide an adopted policy that would substantiate their certification of compliance, while others submitted policies that did not fully address the substance of the Principles.

While our State's collective efforts to implement the Principles have resulted in meaningful progress with respect to investment bank and broker/dealer practices, this office is not satisfied with the degree of compliance indicated in the responses. We remain committed to ensuring that the Principles are broadly implemented in the financial marketplace and believe that compliance by investment banks with the highest possible

Harvey L. Pitt  
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standards of conduct is important to protect investors, taxpayers, and pensioners and to renew faith in our financial institutions.

I am encouraged by the recent announcement that the Securities and Exchange Commission (SEC), the New York Stock Exchange (NYSE), the National Association of Securities Dealers, Inc. (NASD), and the North American Securities Administrators Association (NASAA) will work with Attorney General Spitzer to forge a comprehensive and uniform standard of practices and policies for investment banks. The level of compliance shown in the initial responses to our policy shows us that swift action by your organizations to impose tough and rigorous standards of practice for the investment banking industry is necessary. I hope that you will put into place strong national standards that will foster public confidence in our financial markets.

While I would prefer adoption of a national standard of practice that meets or exceeds the Principles, I believe it is imperative that this office move forward to implement the Principles until such rules are in place. In that vein, please find enclosed the Statement of this office regarding Enforcement of the Principles that summarizes the actions I have taken to date.

As summarized in this Statement, if comprehensive national standards are enacted by January 15, I will reevaluate this office's implementation efforts. I hope that your efforts will speak to the problems that this office has been trying to address through its policy.

Sincerely,

Phil Angelides  
State Treasurer

Enclosure

cc: The Honorable Eliot L. Spitzer, New York State Attorney General